TURNER
Daniels
Whiting

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Opinion No. 55-115

REQUESTED BY: Charles W. Hooper, Arizona State Tax Commission
State Capitol Building, Phoenix, Arizona

OPINION BY: ROBERT MORRISON, The Attorney General
D. Kelly Turner, Assistant Attorney General

QUESTION: 1. Can the State of Arizona tax an out-of-state company which sends salesmen into the state, who only solicit orders and do not make sales in the State of Arizona?

2. Can the Arizona State Tax Commission tax out-of-state companies which operate warehouses in the State of Arizona, out of which are made retail sales and also out of which contracting work is done, and who also have salesmen operating, as in Question No. 1 above, the warehouse and retail sales operation being completely separate from the soliciting of orders and having no connection with each other, except for the same ownership?

CONCLUSION: 1. No.

2. Yes.

The tax imposed by the Excise Revenue Act is not a sales tax, as such, but is a tax upon the privilege of engaging in business, measured by the amount or value of sales made or business done. Commission v. Quebedeaux, 71 Ariz. 280, 226 P.2d 549. The tax, as so defined, is not prohibited by either the state or federal constitutions, under either due process or the interstate commerce clause, when imposed upon gross proceeds, gross receipts or gross income, arising out of business engaged in within Arizona. Duhane v. Commission, 65 Ariz. 268, 179 P.2d 252, 171 A.L.R. 684. The taxable event under the Act is the engaging in business, Commission v. Ensign, 75 Ariz. 220, 254 P.2d 1029.

The solicitation of orders within a state by a salesman for an out-of-state company is doing business within the state by the company to the extent, at least, it subjects the company to the jurisdiction of the courts of this state. International Shoe Co. v. Washington, 326 U.S. 310, 90 L.Ed. 95 at 104:

> "* * * to the extent that a corporation exercises the privilege of conducting activities within a state, it enjoys the benefits and protection of the laws of that state. The exercise of that

> privilege may give rise to obligations, and, so far as those obligations arise out of or are connected with the activities within the state, a procedure which requires the corporation to respond to a suit brought to enforce them can, in most instances, hardly be said to be undue. * * * * * * the activities carried on in behalf of appellant * * * were systematic and continuous throughout the years in question. They resulted in a large volume of interstate business, in the course of which appellant received the benefits and protection of the laws of the state, including the right to resort to the courts for the enforcement of its rights. The obligation which is heresued upon arose out of those very activities. It is evident that these operations establish sufficient contacts or ties with the state of the forum to make it reasonable and just according to our traditional conception of fair play and substantial justice to permit the state to enforce the obligations which appellant has incurred there. * * *"

It follows that the out-of-state company is engaged in business within the state when it sends its salesmen into the state to solicit orders. The question for determination is whether a tax upon the gross income of such company arising from such solicitation is permissible, or whether it is prohibited as a tax upon interstate commerce under Article 1, Section 8, of the Federal Constitution. It is a rule too well established to require citation that a state may not tax an exclusively interstate operation or business. A recent United States Supreme Court case, Miller Bros. v. Maryland, 347 U.S. 346, 98 L.Ed. 749,74 S. Ct. 539, applied the rule with respect to the enforcement of a use tax. The Court held that an out-of-state company, making sales to residents of a taxing state in which it was not doing business, was not required to collect the use tax for the taxing state. An earlier decision, General Trading Co. vs. State Tax Commission, 327 U.S. 335, 80 L. Ed. 1309, held that such out-of-state company is required to collect the use tax on sales, when it sends its salesmen into the buyer's state to solicit orders. Rulings to the same effect were made when the out-of-state seller had retail outlets in the buyer's state. Nelson vs. Sears Roebuck & Co., 312 U.S. 359, 85 L.Ed. 888, 132 A.L.R. 475; Nelson v. Montgomery Ward, 312 U.S. 373, 85 L.Ed. 897.

The distinction between a use tax and a so-called sales or business privilege tax rests largely upon the concept of the imposition of the tax; in the one case, it is imposed upon the buyer or user, and in the other, it is imposed upon the seller. The distinction is important in determining whether or not there is a "doing business" within the taxing jurisdiction. A seller within

the taxing state may not be taxed, obviously, on business not done within the jurisdiction. In the use tax situation, however, the seller may be required to collect for the taxing jurisdiction, even though the tax is imposed upon sales not made within the taxing jurisdiction.

The liability for the business privilege tax depends upon the location of the business activity producing the income which is the measure of the tax. If the income producing activities occur within the taxing state, then the income produced is taxable, even though some of the "business engaged in" is transacted in another state. Commission vs. Ensign, supra.

We conclude that salesman engaged only in solicitation of orders, without more, is not an activity producing taxable income in Arizona, and the out-of-state company using such salesmen is not subject to excise tax on sales to Arizona residents. Where there are other elements than mere solicitation of orders occurring in Arizona, then the result must be different. Solicitation of and acceptance of the order in Arizona, or the delivery of possession and transfer of title in Arizona, will result in a taxable business activity within Arizona.

The out-of-state company, which operates a warehouse in Arizona from which it makes sales and deliveries, is subject to the excise tax on its Arizona-produced income. The activity of salesmen is a part of such business, when the income is produced in Arizona. The facts are analogous to Norton v. Illinois, 340 U.S. 534, 95 L.Ed. 517, relied on in the Ensign case. The Norton case was described by the U.S. Supreme Court in distinguishing Miller Bros. v. Maryland, supra. The Court said in Miller Bros.:

> "This is not the case of a merchant entering a state to maintain a branch and engaging in additionally taxable retail business, but trying to allocate some part of his total sales to non-taxable interstate commerce. Under these circumstances the state has jurisdiction to tax the taxpayer and all that he can question on due process or commerce clause grounds is the validity of the allocation."

The authority to tax contained in the Norton case follows:

> ". . . when, as here, the corporation has gone into the state to do local business by state permission and has submitted itself to the taxing power of the state, it can avoid taxation on some Illinois sales only by showing that particular transactions are disassociated from the local business and interstate in nature."

Thus, it must be concluded in the case of the out-of-state company which operates warehouses in the State of Arizona, out of which are made retail sales, and out of which deliveries of merchandise are made to buyers who purchase through the salesmen soliciting the orders, that the income of all such business conducted in Arizona is taxable. It is only the income disassociated from the Arizona activities; in other words, income from sales made out of Arizona, that is not subject to the excise tax. Where any material part of the sale is consummated in Arizona, such as the acceptance of the order, the transfer of title, the delivery of goods, or the collection of the purchase price, then the company making the sale is doing business within Arizona and must pay the tax upon the privilege of doing such business.

ROBERT MORRISON
The Attorney General

D Kelly Turner

D. KELLY TURNER
Assistant Attorney General

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